FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE
Form 10-Q
May 06, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File No.: 0-50231

Federal National Mortgage Association
(Exact name of registrant as specified in its charter)

Fannie Mae

Federally chartered corporation *(State or other jurisdiction of incorporation or organization)*	**52-0883107** *(I.R.S. Employer Identification No.)*
3900 Wisconsin Avenue, NW **Washington, DC** *(Address of principal executive offices)*	**20016** *(Zip Code)*

Registrant s telephone number, including area code:
(202) 752-7000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o

Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of March 31, 2008, there were 982,319,990 shares of common stock outstanding.

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MD&A TABLE REFERENCE

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PART I FINANCIAL INFORMATION

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

You should read this Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) in conjunction with our unaudited condensed consolidated financial statements and related notes, and the more detailed information contained in our Annual Report on Form 10-K for the year ended December 31, 2007 (2007 Form 10-K). The results of operations presented in our interim financial statements and discussed in MD&A are not necessarily indicative of the results that may be expected for the full year. Please refer to Glossary of Terms Used in This Report in our 2007 Form 10-K for an explanation of key terms used throughout this discussion.

INTRODUCTION

Fannie Mae is a government-sponsored enterprise (GSE), owned by private shareholders (NYSE: FNM) and chartered by Congress to support liquidity and stability in the secondary mortgage market. Our business includes three integrated business segments Single-Family Credit Guaranty, Housing and Community Development, and Capital Markets that work together to provide services, products and solutions to our lender customers and a broad range of housing partners. Together, our business segments contribute to our chartered mission objectives, helping to increase the total amount of funds available to finance housing in the United States and to make homeownership more available and affordable for low-, moderate- and middle-income Americans. We also work with our customers and partners to increase the availability and affordability of rental housing. Although we are a corporation chartered by the U.S. Congress, the U.S. government does not guarantee, directly or indirectly, our securities or other obligations. Our business is self-sustaining and funded exclusively with private capital.

Our **Single-Family Credit Guaranty** (Single-Family) business works with our lender customers to securitize single-family mortgage loans into Fannie Mae mortgage-backed securities (Fannie Mae MBS) and to facilitate the purchase of single-family mortgage loans for our mortgage portfolio. Revenues in the segment are derived primarily from: (i) the guaranty fees received on the mortgage loans underlying single-family Fannie Mae MBS and on the single-family mortgage loans held in our portfolio; and (ii) trust management income, which is a fee we earn derived from interest earned on cash flows between the date of remittance of mortgage and other payments to us by servicers and the date of distribution of these payments to MBS certificateholders.

Our **Housing and Community Development** (HCD) business works with our lender customers to securitize multifamily mortgage loans into Fannie Mae MBS and to facilitate the purchase of multifamily mortgage loans for our mortgage portfolio. Our HCD business also makes debt and equity investments to increase the supply of affordable housing. Revenues in the segment are derived from a variety of sources, including the guaranty fees received on the mortgage loans underlying multifamily Fannie Mae MBS and on the multifamily mortgage loans held in our portfolio, transaction fees associated with the multifamily business, and bond credit enhancement fees. In addition, HCD s investments in rental housing projects eligible for the federal low-income housing tax credit and other investments generate both tax credits and net operating losses that reduce our federal income tax liability. Other investments in rental and for-sale housing generate revenue and losses from operations and the eventual sale of the assets.

Our **Capital Markets** group manages our investment activity in mortgage loans, mortgage-related securities and other investments, our debt financing activity, and our liquidity and capital positions. We fund our investments primarily through proceeds from our issuance of debt securities in the domestic and international capital markets. Our Capital Markets group generates most of its revenue from the difference, or spread, between the interest we earn on our mortgage assets and the interest we pay on the debt we issue to fund these assets. We refer to this spread as our net interest yield. Changes in the fair value of the derivative instruments and trading securities we hold impact the net income or loss reported by the Capital Markets group.

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SELECTED FINANCIAL DATA

The selected financial data presented below is summarized from our condensed consolidated results of operations for the three months ended March 31, 2008 and 2007, as well as from selected condensed consolidated balance sheet data as of March 31, 2008 and December 31, 2007. This data should be read in conjunction with this MD&A, as well as with the unaudited condensed consolidated financial statements and related notes included in this report and with our audited consolidated financial statements and related notes included in our 2007 Form 10-K.

	For the Three Months Ended March 31, 2008	For the Three Months Ended March 31, 2007[1]
	(Dollars and shares in millions, except per share amounts)	
Statement of Operations Data:		
Net interest income	$ 1,690	$ 1,194
Guaranty fee income	1,752	1,098
Losses on certain guaranty contracts		(283)
Trust management income	107	164
Fair value losses, net[2]	(4,377)	(566)
Other income (expenses), net[3]	(170)	400
Credit-related expenses[4]	(3,243)	(321)
Net income (loss)	(2,186)	961
Preferred stock dividends and issuance costs at redemption	(322)	(135)
Net income (loss) available to common stockholders	(2,508)	826
Per Common Share Data:		
Earnings (loss) per share:		
Basic	$ (2.57)	$ 0.85
Diluted	(2.57)	0.85
Weighted-average common shares outstanding:		
Basic	975	973
Diluted	975	974
Cash dividends declared per common share	$ 0.35	$ 0.40
New Business Acquisition Data:		
Fannie Mae MBS issues acquired by third parties[5]	$ 155,702	$ 125,202
Mortgage portfolio purchases[6]	36,323	36,157
New business acquisitions	$ 192,025	$ 161,359

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	As of March 31, 2008	As of December 31, 2007[1]
	(Dollars in millions)	
Balance Sheet Data:		
Investments in securities:		
Trading	$ 110,573	$ 63,956
Available-for-sale	228,228	293,557
Mortgage loans:		
Loans held for sale	8,486	7,008
Loans held for investment, net of allowance	402,449	396,516
Total assets	843,227	879,389
Short-term debt	215,916	234,160
Long-term debt	544,424	562,139
Total liabilities	804,233	835,271
Preferred stock	16,913	16,913
Total stockholders equity	38,836	44,011
Regulatory Capital Data:		
Core capital[7]	$ 42,676	$ 45,373
Total capital[8]	47,666	48,658
Book of Business Data:		
Mortgage portfolio[9]	$ 726,705	$ 727,903
Fannie Mae MBS held by third parties[10]	2,200,958	2,118,909
Other guarantees[11]	40,817	41,588
Mortgage credit book of business	$ 2,968,480	$ 2,888,400
Guaranty book of business[12]	$ 2,827,370	$ 2,744,237

	For the Three Months Ended March 31, 2008	For the Three Months Ended March 31, 2007
Ratios:		
Return on assets ratio[13]*	(1.16)%	0.39%
Return on equity ratio[14]*	(40.9)	10.1
Equity to assets ratio[15]*	4.8	4.9
Dividend payout ratio[16]	N/A	47.2
Average effective guaranty fee rate (in basis points)[17]*	29.5bp	21.8bp
Credit loss ratio (in basis points)[18]*	12.6bp	3.4bp

(1) Certain prior period amounts have been reclassified to conform to the current period presentation.

(2) Consists of the following: (a) derivatives fair value losses, net; (b) gains (losses) on trading securities, net; (c) debt fair value gains, net; and (d) debt foreign exchange gains (losses), net. Certain prior period amounts have been reclassified to conform with the current period presentation in our condensed consolidated statements of operations.

(3) Consists of the following: (a) investment gains (losses), net; (b) debt extinguishment losses, net; (c) losses from partnership investments; and (d) fee and other income. Certain prior period amounts have been reclassified to conform with the current period presentation in our condensed consolidated statements of operations.

(4) Consists of provision for credit losses and foreclosed property expense.

(5) Unpaid principal balance of Fannie Mae MBS issued and guaranteed by us and acquired by third-party investors during the reporting period. Excludes securitizations of mortgage loans held in our portfolio and the purchase of Fannie Mae MBS for our investment portfolio.

(6) Unpaid principal balance of mortgage loans and mortgage-related securities we purchased for our investment portfolio during the reporting period. Includes advances to lenders, mortgage-related securities acquired through the extinguishment of debt and capitalized interest.

(7) The sum of (a) the stated value of outstanding common stock (common stock less treasury stock); (b) the stated value of outstanding non-cumulative perpetual preferred stock; (c) paid-in capital; and (d) our retained earnings. Core capital excludes accumulated other comprehensive income (loss).

(8) The sum of (a) core capital and (b) the total allowance for loan losses and reserve for guaranty losses, less (c) the specific loss allowance (that is, the allowance required on individually impaired loans).

(9) Unpaid principal balance of mortgage loans and mortgage-related securities held in our portfolio.

(10) Unpaid principal balance of Fannie Mae MBS held by third-party investors. The principal balance of resecuritized Fannie Mae MBS is included only once in the reported amount.

(11) Includes single-family and multifamily credit enhancements that we have provided and that are not otherwise reflected in the table.

(12) Unpaid principal balance of: mortgage loans held in our mortgage portfolio; Fannie Mae MBS (whether held in our mortgage portfolio or held by third parties); and other credit enhancements that we provide on mortgage assets. Excludes non-Fannie Mae mortgage-related securities held in our investment portfolio for which we do not provide a guaranty. The principal balance of resecuritized Fannie Mae MBS is included only once in the reported amount.

(13) Annualized net income (loss) available to common stockholders divided by average total assets during the period.

(14) Annualized net income (loss) available to common stockholders divided by average outstanding common equity during the period.

(15) Average stockholders equity divided by average total assets during the period.

(16) Common dividends declared during the period divided by net income (loss) available to common stockholders for the period.

(17) Annualized guaranty fee income as a percentage of average outstanding Fannie Mae MBS and other guarantees during the period.

(18) Annualized (a) charge-offs, net of recoveries and (b) foreclosed property expense, as a percentage of the average guaranty book of business during the period. We exclude from our credit loss ratio any initial losses recorded on delinquent loans purchased from MBS trusts pursuant to Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3), when the purchase price of seriously delinquent loans that we purchase from Fannie Mae MBS trusts exceeds the fair value of the loans at the time of purchase. Our credit loss ratio including the effect of these initial losses recorded pursuant to SOP 03-3 would have been 20.7 basis points and 4.2 basis points for the three months ended March 31, 2008 and 2007, respectively. We previously calculated our credit loss ratio based on credit losses as a percentage of our mortgage credit book of business, which includes non-Fannie Mae mortgage-related securities held in our

mortgage investment portfolio that we do not guarantee. Because losses related to non-Fannie Mae mortgage-related securities are not reflected in our credit losses, we revised the calculation of our credit loss ratio to reflect credit losses as a percentage of our guaranty book of business. Our credit loss ratio calculated based on our mortgage credit book of business would have been 12.0 basis points and 3.2 basis points for the three months ended March 31, 2008 and 2007, respectively.

Note:

* Average balances for purposes of the ratio calculations are based on beginning and end of period balances.

EXECUTIVE SUMMARY

Summary of Our Financial Results

We recorded a net loss of $2.2 billion and a diluted loss per share of $2.57 for the first quarter of 2008, compared with a net loss of $3.6 billion and a diluted loss per share of $3.80 for the fourth quarter of 2007. We recorded net income of $961 million and diluted earnings per share of $0.85 for the first quarter of 2007.

Our results for this quarter reflect the ongoing disruption in the housing, mortgage and credit markets, which continued to deteriorate throughout the quarter. Specific trends that affected our financial results during the quarter included: increases in mortgage delinquencies, defaults and foreclosures; home price declines; lower interest rates; significantly wider credit spreads on securities; and reduced levels of liquidity in the mortgage and credit markets. As we continued to respond to the market s need for liquidity and stability, we also saw continued growth in our single-family and multifamily books of business, market share and guaranty fee revenues, as well as an increase in our net interest income and net interest yield.

Our net loss for the first quarter was driven principally by credit-related expenses and fair value losses on our derivatives and trading securities, which more than offset our net interest income and guaranty fee income for the quarter.

Net interest income and net interest yield increased compared with both the fourth quarter and the first quarter of 2007, due to a reduction in the cost of our short-term debt and our redemption of step-rate debt securities during the quarter.

Guaranty fee income increased compared with both the fourth quarter and the first quarter of 2007, due to an increase in the average guaranty book of business and an increase in our average effective guaranty fee rate. The increase in our average effective guaranty fee rate was primarily attributable to accelerated accretion of the guaranty obligation and deferred profit into guaranty fee income caused by declining mortgage interest rates during the quarter, which caused an increase in expected prepayment rates. Our guaranty fee pricing increases also contributed to the increase in our average effective guaranty fee rate for the quarter.

Credit-related expenses increased compared with both the fourth quarter and the first quarter of 2007. The increase in credit-related expenses compared with the fourth quarter of 2007 was due primarily to an increase in charge-offs. This reflects higher defaults and average loan loss severities, driven by national home price declines and weak economic conditions in the Midwest.

Net fair value losses increased compared with both the fourth quarter and the first quarter of 2007. The primary driver of our net fair value losses for the quarter was our derivatives fair value losses, which were primarily due to the decline in interest rates during the quarter. Also contributing to our net fair value losses for the quarter was an increase in fair value losses on our trading securities, primarily due to the negative impact of a significant widening of credit spreads during the first quarter of 2008, which more than offset the positive impact of the decline in interest rates during the quarter on the fair value of these securities.

As a result of our implementation of a new accounting standard (as discussed in greater detail below), we did not incur any losses at inception of certain guaranty contracts during the first quarter of 2008, which positively impacted our results of operations for the quarter. In comparison, we recorded losses on certain guaranty contracts of $386 million for the fourth quarter of 2007 and $283 million for the first quarter of 2007. In addition, implementation of this new accounting standard contributed to a reduction in the non-GAAP estimated fair value of our net assets as of March 31, 2008, as discussed further in Supplemental Non-GAAP Information Fair Value Balance Sheets.

We provide a more detailed discussion of key factors affecting changes in our results of operations and financial condition in Consolidated Results of Operations, Business Segment Results, Consolidated Balance Sheet Analysis and Supplemental Non-GAAP Information Fair Value Balance Sheets.

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Impact of Market-Based Valuation Adjustments on our Financial Results

The factors that negatively affected our financial results during the first quarter of 2008 included $5.1 billion of losses reflecting market-based valuations related to the adverse conditions in the housing, mortgage and credit markets during the quarter. Table 1 below shows the effect for the three months ended March 31, 2008, December 31, 2007 and March 31, 2007 of the most significant market-based valuation adjustments included in our results of operations.

Table 1: Effect on Results of Operations of Significant Market-Based Valuation Adjustments

	For the Three Months Ended		
	March 31, 2008	December 31, 2007	March 31, 2007
		(Dollars in millions)	
Derivatives fair value losses, net	$ (3,003)	$ (3,222)	$ (563)
Gains (losses) on trading securities, net	(1,227)	(215)	61
Debt fair value gains, net	10		
Debt foreign exchange losses, net	(157)	(2)	(64)
Fair value losses, net	(4,377)	(3,439)	(566)
Losses on certain guaranty contracts		(386)	(283)
SOP 03-3 fair value losses[1]	(728)	(559)	(69)
Total pre-tax effect on earnings	$ (5,105)	$ (4,384)	$ (918)

(1) SOP 03-3 fair value losses refers to fair value losses we record in connection with our purchase of seriously delinquent loans from MBS trusts pursuant to SOP 03-3. SOP 03-3 fair value losses are reflected in our condensed consolidated statements of operations as a component of the Provision for credit losses (which is a component of our Credit-related expenses). For more information regarding our accounting for seriously delinquent loans purchased from MBS trusts, refer to Item 7 MD&A Critical Accounting Policies and Estimates Fair Value of Financial Instruments Fair Value of Loans Purchased with Evidence of Credit Deterioration Effect on Credit-Related Expenses in our 2007 Form 10-K.

We provide a more detailed discussion of the effect of these market-based valuation adjustments on our financial results in Consolidated Results of Operations.

Impact of Credit-Related Expenses on our Financial Results

Our first quarter 2008 results continued to reflect significantly elevated credit-related expenses compared with recent years. Our credit-related expenses for the first quarter of 2008 were 9% higher than for the fourth quarter of 2007, and more than ten times higher than our credit-related expenses for the first quarter of 2007. The key drivers of the increase in credit-related expenses for the quarter were the following:

The provision for credit losses attributable to our guaranty book of business increased to $2.3 billion for the first quarter of 2008, compared with $2.2 billion for the fourth quarter of 2007 and $180 million for the first quarter of 2007. The increase in our provision for the quarter reflects the impact of the severe deterioration in the housing market, including significant increases in default rates and average loan loss severities.

The provision for credit losses attributable to fair value losses recorded in connection with our purchase of seriously delinquent loans from MBS trusts pursuant to AICPA Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3), which we refer to as SOP 03-3 fair value losses, increased to $728 million for the first quarter of 2008, compared with $559 million for the fourth quarter of 2007 and $69 million for the first quarter of 2007. The increase in SOP 03-3 fair value losses compared with the fourth quarter was driven by a reduction in the market price of the delinquent loans we acquired from trusts during the quarter, as a result of the significant disruption in the housing market, which has severely reduced market liquidity for delinquent mortgage loans.

Our foreclosed property expenses were $170 million for the first quarter of 2008, slightly less than our foreclosed property expenses of $179 million for the fourth quarter of 2007, but significantly higher than our foreclosed property expenses of $72 million for the first quarter of 2007.

We substantially increased our loss reserves to reflect credit losses that we believe have been incurred and will be recognized over time in our charge-offs. Our combined loss reserves were $5.2 billion as of March 31, 2008, compared with $3.4 billion as of December 31, 2007 and $930 million as of March 31, 2007.

Our credit loss ratio (which excludes the impact of SOP 03-3 fair value losses) increased to 12.6 basis points for the first quarter of 2008, compared with 8.1 basis points for the fourth quarter of 2007 and 3.4 basis points for the first quarter of 2007. Our credit loss ratio including the effect of SOP 03-3 fair value losses would have been 20.7 basis points, 14.8 basis points and 4.2 basis points for those respective periods. Our credit losses for the quarter were concentrated primarily in our Alt-A and other higher risk loan categories, in loans originated in 2005 through 2007, and in areas of the country experiencing steep declines in home prices (such as Florida, California, Nevada and Arizona) or prolonged economic weakness (such as Ohio, Indiana and Michigan).

We provide a more detailed discussion of our credit-related expenses and credit loss performance metrics in Consolidated Results of Operations Credit-Related Expenses. We also provide detailed credit performance information, including serious delinquency rates by geographic region, statistics on nonperforming loans and foreclosed property activity, in Risk Management Credit Risk Management Mortgage Credit Risk Management Mortgage Credit Book of Business Performance.

Impact of Recent Changes in Fair Value Accounting on our Financial Results

Our financial results for the first quarter of 2008 were affected by our adoption of the following new accounting standards relating to the valuation of the financial instruments we hold.

Fair Value Option. In connection with our adoption of Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), effective January 1, 2008, we elected to report a larger portion of our financial instruments at fair value, with changes in the fair value of these instruments included in our results of operations. The financial instruments that we will now record at fair value through our results of operations include our non-mortgage-related securities, certain agency mortgage-related securities and certain structured debt instruments. Because changes in the fair value of mortgage-related securities resulting from changes in interest rates tend to offset the impact of interest rate changes on the fair value of our derivatives, we expect this election to reduce some of the volatility in our financial results. In connection with our election to report additional financial instruments at fair value, we now report all changes in the fair value of our trading securities, debt and derivatives collectively in the Fair value losses, net line item of our condensed consolidated statement of operations.

Fair Value Measurements. In connection with our adoption of SFAS No. 157, *Fair Value Measurements* (SFAS 157), on January 1, 2008, we implemented a prospective change in our method of measuring the fair value of the guaranty obligations we incur when we enter into guaranty contracts. This change results in the recognition of our guaranty obligations at the amount of the compensation we receive on our guaranty contracts. Accordingly, we no longer recognize losses or record deferred profit in our financial statements at inception of our guaranty contracts issued after December 31, 2007. This change had a favorable impact on our results of operations for the quarter. We believe this method of measuring the fair value of our guaranty obligations provides a more meaningful presentation of our guaranty obligations by better aligning the revenue we recognize for providing our guarantees with the total compensation we receive and by reflecting the pricing of actual market transactions. Although we will no longer recognize losses at the inception of our guaranty contracts, we will continue to accrete previously recognized losses into our guaranty fee income over time until these losses have been fully amortized. This change in our method of measuring the fair value of our guaranty obligations contributed to a reduction in the non-GAAP estimated fair value of our net assets as of March 31, 2008.

For more information on the effect of these changes on our results of operations and the estimated fair value of our net assets, refer to Critical Accounting Policies and Estimates Change in Measuring the Fair Value of Guaranty Obligations and Supplemental Non-GAAP Information Fair Value Balance Sheets.

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In addition to the changes described above, beginning in mid-April 2008, we implemented fair value hedge accounting with respect to a portion of our derivatives to hedge, for accounting purposes, changes in the fair value of some of our mortgage assets attributable to changes in interest rates. As a result of our election to report a larger portion of our financial instruments at fair value pursuant to SFAS 159 and our implementation of hedge accounting, we expect a reduction in the level of volatility in our financial results that is attributable to changes in interest rates. However, our implementation of SFAS 159 and hedge accounting will not affect our exposure to spread risk or the volatility in our financial results that is attributable to changes in credit spreads.

Recent Legislative and Regulatory Developments

Recent OFHEO Actions

The Office of Federal Housing Enterprise Oversight (OFHEO), our safety and soundness regulator, has recently taken the following actions:

Effective March 1, 2008, OFHEO removed the limitation on the size of our mortgage portfolio.

On March 19, 2008, OFHEO reduced the capital surplus requirement set forth in our May 2006 consent order with OFHEO from 30% to 20%. OFHEO also announced that we were in full compliance with the May 2006 consent order.

OFHEO has informed us that it has lifted the May 2006 consent order effective May 6, 2008, and will reduce the current OFHEO-directed capital surplus requirement from 20% to 15% upon the successful completion of our capital-raising plan described below. OFHEO also indicated its intention to reduce the capital surplus requirement by an additional 5 percentage points to a 10% surplus requirement in September 2008, based upon our continued maintenance of excess capital well above OFHEO s regulatory requirement and no material adverse change to our ongoing regulatory compliance.

Determination by HUD Regarding 2007 Home Purchase Subgoals

As described in our 2007 Form 10-K, we believe that we did not meet our low- and moderate-income housing and special affordable housing home purchase subgoals for 2007 established by the Department of Housing and Urban Development (HUD). In April 2008, HUD notified us of its determination that achievement of these subgoals was not feasible, primarily due to reduced housing affordability and turmoil in the mortgage market, which reduced the share of the conventional conforming primary home purchase market that would qualify for these subgoals. As a result, we will not be required to submit a housing plan for failure to meet the special affordable housing home purchase subgoal. Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, the low- and moderate-income housing home purchase subgoal is not enforceable.

Legislation Relating to Our Regulatory Framework

As described in our 2007 Form 10-K, there is legislation pending before the U.S. Congress that would change the regulatory framework under which we, the Federal Home Loan Mortgage Corporation (referred to as Freddie Mac) and the Federal Home Loan Banks operate. The House of Representatives approved a GSE reform bill in May 2007. Another GSE reform bill is expected to be introduced in the Senate in May 2008. We cannot predict the content of any Senate bill that may be introduced or its prospects for passage by the Congress. For a description of how changes in the regulation of our business and other legislative proposals could materially adversely affect our business and earnings, see Item 1A Risk Factors of our 2007 Form 10-K.

Response to Market Challenges and Opportunities

Although our financial performance for the first quarter of 2008 continued to be negatively affected by the continuing weakness in the housing markets and disruption in the mortgage and credit markets, these challenging conditions also provided opportunities for us to both fulfill our mission and build a stronger competitive position for the longer term. Our principal strategy for responding to the current challenging market conditions is to prudently preserve and build our capital, while building a solid mortgage credit book of business and continuing to fulfill our chartered mission of providing liquidity, stability and affordability to the secondary mortgage market. We identify below a number of the steps we have taken and are taking to achieve that strategy.

Preserving and Building Capital

We intend to continue to take aggressive management actions to preserve and further build our capital. OFHEO s reduction of the capital surplus requirement will facilitate our capital management efforts and enhance our ability to provide additional liquidity and stability to the secondary mortgage market.

We are also planning to raise $6 billion in new capital through public offerings of common stock, non-cumulative mandatory convertible preferred stock and non-cumulative, non-convertible preferred stock. We believe that this additional capital will enable us to pursue growth and investment opportunities while also maintaining a prudent capital cushion in a volatile and challenging market. As part of our plan to raise capital, our Board of Directors indicated it intends to reduce our quarterly common stock dividend beginning with the third quarter of 2008 to $0.25 per share, which will make available approximately $390 million of capital annually. For more information regarding our planned capital raise, refer to Liquidity and Capital Management Capital Management Capital Activity Capital Management Actions.

Prior to OFHEO s reduction of the capital surplus requirement on March 19, our need to maintain capital at levels sufficient to ensure we would meet our regulatory capital requirements continued to constrain our business activities during the first quarter. We therefore continued to take steps during the first quarter to bolster our capital position, including managing the size of our investment portfolio and limiting or forgoing business opportunities that we otherwise would have pursued.

Building a Solid Mortgage Credit Book of Business by Managing and Mitigating Credit Exposure

We have continued during the first quarter of 2008 to implement a variety of measures designed to help us manage and mitigate the credit exposure we face as a result of our investment and guaranty activities, including the following measures.

Tightening Our Underwriting and Eligibility Guidelines

We implemented several changes in our underwriting and eligibility criteria during the first quarter of 2008 to reduce our credit risk, including requiring larger down payments, higher credit scores and increased pricing for some of the loans we acquire. We have also limited or eliminated our acquisitions of certain higher risk loan products. We believe our new underwriting and eligibility criteria will promote stable financing and sustainable homeownership, particularly in the current market environment in which home prices are declining in many areas.

In March 2008, we announced the release of Desktop Underwriter® Version 7.0 (DU 7.0), which will become effective in June 2008. With the release of DU 7.0, we will implement a comprehensive update to DU s credit risk assessment, as well as pricing requirements that align with this update. In connection with the release of DU 7.0, we will also update the pricing and eligibility requirements for our manually underwritten loans to more closely align with our requirements for loans underwritten through DU, which will allow us to more consistently manage our credit risk for the loans we acquire.

We believe these efforts to reduce our credit risk, particularly in the current market environment, are essential to our ability to sustain our business over the long term. By prudently managing our credit risk during this difficult market cycle, we help to ensure that we have the financial strength to continue to provide liquidity to the mortgage market, help stabilize that market and support continued, affordable homeownership.

Increasing Our Guaranty Fees

We have taken steps during the first quarter of 2008 to increase our guaranty fees in light of the increased credit risk and volatility in the current market environment. In March 2008, we increased our guaranty fees and implemented an adverse market delivery charge of 25 basis points on all loans delivered to us to compensate us for the added risk we incur during this period of increased market uncertainty. We also have announced further increases in our guaranty fees for some loan types beginning in June 2008 and August 2008.

Loss Mitigation Activities

We have also taken steps to reduce credit losses and help borrowers stay in their homes, including the following:

We have increased our credit operations staff dedicated to on-site oversight at the offices of our largest loan servicers to help guide loss mitigation decisions and ensure adherence to our policies.

We have implemented our HomeSaver Advance[tm] initiative, a loss mitigation tool that permits qualified borrowers who are behind on their mortgage loans to catch up on their payments without the need to modify the mortgage loans.

We have extended our maximum collection forbearance period for delinquent loans from four to six months.

We have increased our fees to those involved in the foreclosure process, including loan servicers and attorneys, to provide a workout solution for a delinquent mortgage loan, rather than proceeding with a foreclosure action.

We are continuing to explore additional loss mitigation actions. For a further description of loss mitigation initiatives we have recently implemented, refer to Risk Management Credit Risk Management Mortgage Credit Risk Management Recent Developments.

Providing Liquidity, Stability and Affordability to the Secondary Mortgage Market

The mortgage and credit market disruption has created a need for additional credit and liquidity in the secondary mortgage market. In 2008, we have taken the following actions to provide liquidity, stability and affordability to the housing finance system:

We continued to increase our participation in the securitization of mortgage loans, with our estimated market share of new single-family mortgage-related securities issuances increasing to approximately 50.1% for the first quarter of 2008, from approximately 48.5% for the fourth quarter of 2007 and approximately 25.1% for the first quarter of 2007.

We increased our total mortgage credit book of business by 3% to $3.0 trillion as of March 31, 2008, from $2.9 trillion as of December 31, 2007.

We began acquiring jumbo conforming loans in April 2008 in response to the Economic Stimulus Act of 2008, which temporarily increased our maximum loan limit in specified high-cost metropolitan areas to $729,750.

In addition, we plan to pursue a series of initiatives designed to help stabilize the housing market and increase home affordability in the United States.

Outlook for 2008

We expect severe weakness in the housing market to continue in 2008. We expect home prices to decline 7 to 9% on a national basis in 2008, with significant regional differences in the rate of home price decline, including steeper declines in certain areas such as Florida, California, Nevada and Arizona. We believe this housing market weakness will lead to increased delinquencies, defaults and foreclosures on mortgage loans, and slower growth in

U.S. residential mortgage debt outstanding in 2008. Based on our market outlook, we currently have the following expectations about our future financial performance.

We expect the downturn in the housing market and the disruption in the mortgage and credit markets to continue to adversely affect our financial results in 2008.

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We expect a significant increase in our credit-related expenses and credit loss ratio in 2008 relative to 2007.

We also believe that our credit losses will increase in 2009 relative to 2008.

We believe that our single-family guaranty book of business will continue to grow at a faster rate than the rate of overall growth in U.S. residential mortgage debt outstanding, and that our guaranty fee income will also grow in 2008 compared to 2007. Our single-family business volume has benefited in recent months from a significant reduction in competition from private issuers of mortgage-related securities and reduced demand for mortgage assets from other market participants. We expect to experience increased competition in 2008 from the Federal Housing Administration (FHA) due to the recent increase in the maximum loan limit for an FHA-insured loan in specified high-cost metropolitan areas to $729,750, from a previous limit of $362,790, pursuant to the Economic Stimulus Act of 2008. This increase in competition from the FHA may negatively affect our single-family business volume in 2008. Our single-family business volume may also be negatively affected by the eligibility changes and additional price increases that we are implementing this year.

If current market conditions continue, we expect our taxable-equivalent net interest yield (excluding the benefit we received from the redemption of step-rate debt securities during the first quarter of 2008) to continue to increase for the remainder of 2008.

We provide additional detail on trends that may affect our result of operations, financial condition, liquidity and regulatory capital position in future periods in Consolidated Results of Operations below.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. In our 2007 Form 10-K, we identified the following as our most critical accounting polices and estimates:

Fair Value of Financial Instruments

Other-than-temporary Impairment of Investment Securities

Allowance for Loan Losses and Reserve for Guaranty Losses

During the first quarter of 2008, we added the assessment of the need for a deferred tax asset valuation allowance as a critical accounting policy. We describe below the basis for including this accounting estimate as a critical accounting policy. We also describe any significant changes in the judgments and assumptions we made during the first quarter of 2008 in applying our critical accounting policies. Also see Part II Item 7 MD&A Critical Accounting Policies and Estimates and Notes to Consolidated Financial Statements Note 1, Summary of Significant Accounting Policies of our 2007 Form 10-K for additional information.

Fair Value of Financial Instruments

We adopted SFAS 157, which defines fair value, establishes a framework for measuring fair value and outlines a fair value hierarchy based on the inputs to valuation techniques used to measure fair value, effective January 1, 2008.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (also referred to as an exit price). SFAS 157 categorizes fair value measurements into a three-level hierarchy based on the extent to which the measurement relies on observable market inputs in measuring fair value. Level 1, which is the highest priority in the fair value hierarchy, is based on unadjusted quoted prices in active markets for identical assets or liabilities. Level 2 is based on observable market-based inputs, other than quoted prices, in active markets for identical assets or liabilities. Level 3, which is the lowest priority in the fair value hierarchy, is based on unobservable inputs. Assets and liabilities are classified within this hierarchy in their entirety based on the lowest level of any input that is significant to the fair value measurement.

The use of fair value to measure our financial instruments is fundamental to our financial statements and is a critical accounting estimate because a substantial portion of our assets and liabilities are recorded at estimated fair value. The majority of our financial instruments carried at fair value fall within the level 2 category and are valued primarily utilizing inputs and assumptions that are observable in the marketplace, can be derived from observable market data or corroborated by observable levels at which transactions are executed in the marketplace. Because items classified as level 3 are generally based on unobservable inputs, the process to determine fair value is generally more subjective and involves a high degree of management judgment and assumptions. These assumptions may have a significant effect on our estimates of fair value, and the use of different assumptions as well as changes in market conditions could have a material effect on our results of operations or financial condition. We provide additional information regarding our level 3 assets below.

Fair Value Hierarchy Level 3 Assets

Level 3 is primarily comprised of financial instruments whose fair value is estimated based on valuation methodologies utilizing significant inputs and assumptions that are generally less readily observable because of limited market activity or little or no price transparency. We typically classify financial instruments as level 3 if the valuation is based on inputs from a single source, such as a dealer quotation, where we are not able to corroborate the inputs and assumptions with other available, relevant market information. Our level 3 financial instruments include certain mortgage- and asset-backed securities and residual interests, certain performing residential mortgage loans, non-performing mortgage-related assets, our guaranty assets and buy-ups, our master servicing assets and certain highly structured, complex derivative instruments.

Some of our financial instruments, such as our trading and available-for-sale (AFS) securities and our derivatives, are measured at fair value on a recurring basis in periods subsequent to initial recognition. We measure some of our other financial instruments at fair value on a nonrecurring basis in periods subsequent to initial recognition, such as assets subject to other-than-temporary impairment. Table 2 presents, by balance sheet category, the amount of financial assets carried in our condensed consolidated balance sheets at fair value on a recurring basis and classified as level 3 as of March 31, 2008. We also identify the types of financial instruments within each asset category that are based on level 3 measurements and describe the valuation techniques used for determining the fair value of these financial instruments. The availability of observable market inputs to measure fair value varies based on changes in market conditions, such as liquidity. As a result, we expect the financial instruments carried at fair value on a recurring basis and classified as level 3 to vary each period.

Table 2: Level 3 Recurring Assets at Fair Value

	As of March 31, 2008	
Balance Sheet Category	**Estimated Fair Value**	**Description and Valuation Technique**
	(Dollars in millions)	
Trading securities	$ 17,972	Primarily consists of mortgage-related securities backed by Alt-A loans and subprime loans. We generally have estimated the fair value based on

the use of average prices obtained from multiple pricing services. In the absence of such information or if we are not able to corroborate these prices by other available, relevant market information, we estimate the fair value based on broker or dealer quotations or using internal calculations that incorporate inputs that are implied by market prices for similar securities and structure types. These inputs may be adjusted for various factors, such as prepayment speeds and credit spreads.

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Balance Sheet Category	As of March 31, 2008 Estimated Fair Value (Dollars in millions)	Description and Valuation Technique
AFS securities	36,183	Primarily consists of mortgage-related securities backed by Alt-A loans and subprime loans and mortgage revenue bonds. The valuation techniques are the same as above.
Derivatives assets	341	Primarily consists of a limited population of certain highly structured, complex interest rate management derivatives. Examples include certain swaps with embedded caps and floors or reference to non-standard indexes. We determine the fair value of these derivative instruments using indicative market prices obtained from large, experienced dealers. Indicative market prices from a single source that cannot be corroborated are classified as level 3.
Guaranty assets and buy-ups	1,628	Represents the present value of the estimated compensation we expect to receive for providing our guaranty related to retained interests in portfolio securitization transactions. We generally have estimated the fair value based on internal models that calculate the present value of expected cash flows. Key model inputs and assumptions include prepayment speeds, forward yield curves and discount rates that are commensurate with the level of estimated risk.
Level 3 recurring assets	$ 56,124	
Total assets	$ 843,227	
Total recurring assets measured at fair value	$ 341,461	
Total recurring assets measured at fair value as percentage of total assets	40%	
Level 3 recurring assets as percentage of total assets	7%	
Level 3 recurring assets as a percentage of total recurring assets measured at fair value	16%	

Level 3 recurring assets totaled $56.1 billion as of March 31, 2008, which represented a significant increase from our level 3 recurring assets as of January 1, 2008. The increase during the first quarter of 2008 primarily reflected the ongoing effects of the significant disruption in the mortgage market and severe reduction in market liquidity for certain mortgage products, such as delinquent loans and private-label mortgage-related securities backed by Alt-A loans and subprime loans. Because of the reduction in recently executed transactions and market price quotations for these instruments, the market inputs for these instruments became less observable.

Financial assets measured at fair value on a non-recurring basis and classified as level 3, which are not presented in the table above, include held-for-sale (HFS) loans that are measured at lower of cost or market and that were written down to fair value as of the end of the period. The fair value of these loans totaled $596 million as of March 31, 2008. In addition, certain financial assets measured at cost that have been written down to fair value during the period due to impairment are classified as non-recurring. The fair value of these level 3 non-recurring financial assets, which primarily consisted of certain guaranty assets and buy-ups, totaled $6.2 billion as of March 31, 2008. Financial liabilities measured at fair value on a recurring basis and classified as level 3 as of March 31, 2008 consisted of $3.4 billion of long-term debt and $89 million of derivatives liabilities. See Notes to Condensed Consolidated Financial Statements Note 16, Fair Value of Financial Instruments for further information regarding SFAS 157, including the classification within the three-level hierarchy of all of our assets and liabilities carried in our condensed consolidated balance sheets at fair value as of March 31, 2008.

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Fair Value Control Processes

We employ control processes to validate the fair value of our financial instruments. These control processes are designed to ensure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable market-based inputs are not available, the control processes are designed to assure that the valuation approach used is appropriate and consistently applied and that the assumptions are reasonable. Our control processes provide for segregation of duties and oversight of our fair value methodologies and valuations by our Valuation Oversight Committee. Valuations are performed by personnel independent of our business units. A price verification group reviews selected valuations and compares the valuations to alternative external market data (*e.g.,* quoted market prices, broker or dealer quotations, pricing services, recent trading activity and comparative analyses to similar instruments) for reasonableness. The price verification group also performs independent reviews of the assumptions used in determining the fair value of products with material estimation risk for which observable market-based inputs do not exist. Valuation models are regularly reviewed and approved for use for specific products by the Chief Risk Office, which also is independent from our business units. Any changes to the valuation methodology or pricing are reviewed by the Valuation Oversight Committee to confirm the changes are appropriate.

We continue to refine our valuation methodologies as markets and products develop and the pricing for certain products becomes more or less transparent. While we believe our valuation methods are appropriate and consistent with those of other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a materially different estimate of fair value as of the reporting date.

Change in Measuring the Fair Value of Guaranty Obligations

Beginning January 1, 2008, as part of the implementation of SFAS 157, we changed our approach to measuring the fair value of our guaranty obligation. Specifically, we adopted a measurement approach that is based upon an estimate of the compensation that we would require to issue the same guaranty in a standalone arm s-length transaction with an unrelated party. When we initially recognize a guaranty issued in a lender swap transaction after December 31, 2007, we measure the fair value of the guaranty obligation based on the fair value of the total compensation we receive, which primarily consists of the guaranty fee, credit enhancements, buy-downs, risk-based price adjustments and our right to receive interest income during the float period in excess of the amount required to compensate us for master servicing. Because the fair value of those guaranty obligations now equals the fair value of the total compensation we receive, we do not recognize losses or record deferred profit in our financial statements at inception of those guaranty contracts issued after December 31, 2007.

We also changed the way we measure the fair value of our existing guaranty obligations, as disclosed in Supplemental Non-GAAP Information Fair Value Balance Sheets and in Notes to Condensed Consolidated Financial Statements, to be consistent with our new approach for measuring guaranty obligations at initial recognition. The fair value of all guaranty obligations measured subsequent to their initial recognition, is our estimate of a hypothetical transaction price we would receive if we were to issue our guarantees to an unrelated party in a standalone arm s-length transaction at the measurement date. To measure this fair value, we will continue to use the models and inputs that we used prior to our adoption of SFAS 157 and calibrate those models to our current market pricing.

Prior to January 1, 2008, we measured the fair value of the guaranty obligations that we recorded when we issued Fannie Mae MBS based on market information obtained from spot transaction prices. In the absence of spot transaction data, which was the case for the substantial majority of our guarantees, we used internal models to estimate the fair value of our guaranty obligations. We reviewed the reasonableness of the results of our models by comparing those results with available market information. Key inputs and assumptions used in our models included the amount of compensation required to cover estimated default costs, including estimated unrecoverable principal and interest that we expected to incur over the life of the underlying mortgage loans backing our Fannie Mae MBS, estimated foreclosure-related costs, estimated administrative and other costs related to our guaranty, and an estimated market risk premium, or profit, that a market

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participant of similar credit standing would require to assume the obligation. If our modeled estimate of the fair value of the guaranty obligation was more or less than the fair value of the total compensation received, we recognized a loss or recorded deferred profit, respectively, at inception of the guaranty contract. See Part II Item 7 MD&A Critical Accounting Policies and Estimates Fair Value of Guaranty Assets and Guaranty Obligations Effect on Losses on Certain Guaranty Contracts of our 2007 Form 10-K for additional information.

The accounting for our guarantees in our condensed consolidated financial statements is unchanged with our adoption of SFAS 157. Accordingly, the guaranty obligation amounts recorded in our condensed consolidated balance sheets attributable to guarantees issued prior to January 1, 2008 will continue to be amortized in accordance with our established accounting policy. This change, however, affects the fair value of all our existing guaranty obligations as of each measurement date, which we disclose in Notes to Condensed Consolidated Financial Statements and Supplemental Non-GAAP Information Fair Value Balance Sheets. As a result of this change, the fair value of our guaranty obligations as of December 31, 2007 decreased by $2.3 billion, to an estimated $18.2 billion, from the previously reported amount of $20.5 billion, effective upon our January 1, 2008 adoption of SFAS 157.

Deferred Tax Assets

We recognize deferred tax assets and liabilities for the future tax consequences related to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and for tax credits. Our net deferred tax assets totaled $17.8 billion and $13.0 billion as of March 31, 2008 and December 31, 2007, respectively. We evaluate our deferred tax assets for recoverability based on available evidence, including assumptions about future profitability. We are required to establish a valuation allowance for deferred tax assets if we determine, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, we estimate future taxable income based on management approved business plans and ongoing tax planning strategies. We did not record a valuation allowance against our net deferred tax assets as of March 31, 2008 or December 31, 2007 because we anticipate that it is more likely than not that our results of future operations will generate sufficient taxable income to allow us to realize our deferred tax assets.

If we were to determine that we would not be able to realize all or a portion of our deferred tax assets in the future, we would reduce the deferred tax asset through a charge to income in the period in which that determination is made. This charge could have a material adverse affect on our results of operations and financial condition. In addition, the assumptions in making this determination are subject to change from period to period based on changes in tax laws or variances between our future projected operating performance and our actual results. As a result, significant management judgment is required in assessing the possible need for a deferred tax asset valuation allowance. For these reasons and because changes in these assumptions and estimates can materially affect our results of operations and financial condition, we have included the assessment of a deferred tax asset valuation allowance as a critical accounting policy.

Our analysis of the need for a valuation allowance recognizes that we are in a cumulative loss position as of the three-year period ended March 31, 2008, which is considered significant negative evidence that is objective and verifiable and therefore, difficult to overcome. However, we believe we will generate sufficient taxable income in future periods to realize deferred tax assets.

We are able to rely on our forecasts of future taxable income and overcome the uncertainty created by the cumulative loss position. While current market conditions create volatility in our pre-tax income, we have sufficient taxable income currently and in our forecasts because of the stability of our core business model and the nature of our book to tax differences. Our forecasts of future taxable income include assumptions about the depth and severity of housing price depreciation and credit losses; if future actual results adversely deviate in a material way, or if unforeseen events preclude our ability to maintain our funding spreads or manage our guaranty fees, we may not generate sufficient taxable income to realize our deferred tax assets, and a

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significant valuation allowance may be necessary. We will continue to assess the need for a valuation allowance.

We provide additional detail on the components of our deferred tax assets and deferred tax liabilities as of December 31, 2007 in our 2007 Form 10-K in Notes to Consolidated Financial Statements Note 11, Income Taxes and we provide information on the increase in our deferred tax assets since December 31, 2007 in Notes to Condensed Consolidated Financial Statements Note 10, Income Taxes of this report.

CONSOLIDATED RESULTS OF OPERATIONS

The following discussion of our condensed consolidated results of operations is based on a comparison of our results for the first quarter of 2008 and the first quarter of 2007. Table 3 presents a summary of our unaudited condensed consolidated results of operations for each of these periods.

Table 3: Summary of Condensed Consolidated Results of Operations

	For the Three Months Ended March 31,		Variance	
	2008	2007	$	%
	(Dollars in millions, except per share amounts)			
Net interest income	$ 1,690	$ 1,194	$ 496	42%
Guaranty fee income	1,752	1,098	654	60
Trust management income	107	164	(57)	(35)
Fee and other income(1)	227	277	(50)	(18)
Net revenues	**3,776**	**2,733**	**1,043**	**38**
Losses on certain guaranty contracts		(283)	283	100
Investment gains (losses), net(1)	(111)	295	(406)	(138)
Fair value losses, net(1)	(4,377)	(566)	(3,811)	(673)
Losses from partnership investments	(141)	(165)	24	15
Administrative expenses	(512)	(698)	186	27
Credit-related expenses(2)	(3,243)	(321)	(2,922)	(910)
Other non-interest expenses(1)(3)	(505)	(104)	(401)	(386)
Income (loss) before federal income taxes and extraordinary losses	(5,113)	891	(6,004)	(674)
Benefit for federal income taxes	2,928	73	2,855	3,911
Extraordinary losses, net of tax effect	(1)	(3)	2	67
Net income (loss)	**$ (2,186)**	**$ 961**	**$ (3,147)**	**(327)%**
Diluted earnings (loss) per common share	**$ (2.57)**	**$ 0.85**	**$ (3.42)**	**(402)%**

(1) Certain prior period amounts have been reclassified to conform with the current period presentation in our condensed consolidated statements of operations.

(2) Consists of provision for credit losses and foreclosed property expense.

(3) Consists of debt extinguishment gains (losses), net, minority interest in earnings of consolidated subsidiaries and other expenses.

Our business generates revenues from four principal sources: net interest income, guaranty fee income, trust management income, and fee and other income. Other significant factors affecting our results of operations include: changes in the fair value of our derivatives, trading securities and debt; the timing and size of investment gains and losses; credit-related expenses; losses from partnership investments; and administrative expenses. We provide a comparative discussion of the effect of our principal revenue sources and other listed items on our condensed consolidated results of operations for the three months ended March 31, 2008 and

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2007 below. We also discuss other significant items presented in our unaudited condensed consolidated statements of operations.

Net Interest Income

Table 4 presents an analysis of our net interest income and net interest yield for the three months ended March 31, 2008 and 2007.

Table 4: Analysis of Net Interest Income and Yield

	For the Three Months Ended March 31,					
	2008			2007		
	Average Balance[1]	Interest Income/ Expense	Average Rates Earned/Paid	Average Balance[1]	Interest Income/ Expense	Average Rates Earned/Paid
	(Dollars in millions)					
Interest-earning assets:						
Mortgage loans[2]	$ 410,318	$ 5,662	5.52%	$ 385,810	$ 5,385	5.58%
Mortgage securities	315,795	4,144	5.25	331,229	4,567	5.52
Non-mortgage securities[3]	66,630	678	4.03	62,195	836	5.37
Federal funds sold and securities purchased under agreements to resell	36,233	393	4.29	13,666	182	5.32
Advances to lenders	4,229	65	6.08	4,674	36	3.11
Total interest-earning assets	$ 833,205	$ 10,942	5.25%	$ 797,574	$ 11,006	5.52%
Interest-bearing liabilities:						
Short-term debt	$ 257,445	$ 2,558	3.93%	$ 161,575	$ 2,213	5.48%
Long-term debt	545,549	6,691	4.91	602,804	7,596	5.04
Federal funds purchased and securities sold under agreements to repurchase	448	3	2.65	210	3	5.33
Total interest-bearing liabilities	$ 803,442	$ 9,252	4.59%	$ 764,589	$ 9,812	5.13%
Impact of net non-interest bearing funding	$ 29,763		0.16%	$ 32,985		0.21%
Net interest income/net interest yield[4]		$ 1,690	0.82%		$ 1,194	0.60%
Taxable-equivalent adjustment on tax-exempt investments[5]		83	0.04%		92	0.04%
Taxable-equivalent net interest income/taxable-equivalent net interest yield[6]		$ 1,773	0.86%		$ 1,286	0.64%

(1) For mortgage loans, average balances have been calculated based on the average of the amortized cost amounts at the beginning of the year and at the end of each month in the period. For all other categories, average balances have been calculated based on a daily average. The average balance for the three months ended March 31, 2008 for advances to lenders also has been calculated based on a daily average.

(2) Average balance amounts include nonaccrual loans with an average balance totaling $8.2 billion and $6.5 billion as of March 31, 2008 and December 31, 2007, respectively, and $5.9 billion and $6.7 billion as of March 31, 2007 and December 31, 2006, respectively. Interest income amounts include interest income related to SOP 03-3 loans, including accretion on loans returned to accrual status, of $145 million and $104 million for the three months ended March 31, 2008 and 2007, respectively. Of these amounts recognized into interest income, $35 million and $7 million for the three months ended March 31, 2008 and 2007, respectively, related to the accretion of the fair value loss recorded upon purchase of SOP 03-3 loans.

(3) Includes cash equivalents.

(4) Net interest yield computed by dividing annualized net interest income for the period by the average balance of total interest-earning assets during the period.

(5) Represents adjustment to permit comparison of yields on tax-exempt and taxable assets calculated using a 35% marginal tax rate for each of the periods presented.

(6) Taxable-equivalent net interest yield is computed by dividing annualized taxable-equivalent net interest income for the period by the average balance of total interest-earning assets during the period.

Table 5 presents the total variance, or change, in our taxable-equivalent net interest income between the three months ended March 31, 2008 and 2007, and the extent to which that variance is attributable to (1) changes in the volume of our interest-earning assets and interest-bearing liabilities or (2) changes in the interest rates of these assets and liabilities.

Table 5: Rate/Volume Analysis of Net Interest Income

	For the Three Months Ended March 31, 2008 vs. 2007		
	Total Variance	Variance Due to:[1] Volume	Rate
	(Dollars in millions)		
Interest income:			
Mortgage loans[2]	$ 277	$ 339	$ (62)
Mortgage securities	(423)	(208)	(215)
Non-mortgage securities	(158)	56	(214)
Federal funds sold and securities purchased under agreements to resell	211	250	(39)
Advances to lenders	29	(4)	33
Total interest income	(64)	433	(497)
Interest expense:			
Short-term debt	345	1,067	(722)
Long-term debt	(905)	(706)	(199)
Federal funds purchased and securities sold under agreements to repurchase		2	(2)
Total interest expense	(560)	363	(923)
Net interest income	496	70	426
Taxable-equivalent adjustment on tax-exempt investments[3]	(9)		
Taxable-equivalent net interest income	$ 487		

(1) Combined rate/volume variances are allocated to both rate and volume based on the relative size of each variance.

(2) Includes interest income related to SOP 03-3 loans, including accretion on loans returned to accrual status, of $145 million and $104 million for the three months ended March 31, 2008 and 2007, respectively. Of these amounts recognized into interest income, approximately $35 million and $7 million for the three months ended March 31, 2008 and 2007, respectively, related to the accretion of the fair value discount recorded upon

purchase of SOP 03-3 loans.

(3) Represents adjustment to permit comparison of yields on tax-exempt and taxable assets calculated using a 35% marginal tax rate for each of the periods presented.

Taxable-equivalent net interest income of $1.8 billion for the first quarter of 2008 increased by 38% from the first quarter of 2007, driven by a 34% (22 basis points) increase in our taxable-equivalent net interest yield to 0.86%, and a 4% increase in our average interest-earning assets. During the first quarter of 2008, the U.S. Treasury yield curve assumed its steepest slope since mid-2004 as short-term interest rates fell and long-term rates remained relatively stable. Our net interest yield reflected the benefits from this steeper yield curve, as we shifted our funding mix to a higher proportion of lower-rate, short-term debt and redeemed $12.5 billion of step-rate debt securities during the quarter, which together reduced the average cost of our debt by 54 basis points, to 4.59%. Instead of having a fixed coupon for the life of the security, step-rate debt securities allow for the interest rate to increase at predetermined rates according to a specified schedule, resulting in increased interest payments. However, the interest expense on step-rate debt securities is recognized at a constant effective rate over the term of the security. Because we redeemed these securities prior to maturity, we reversed a portion of the interest expense that we had previously accrued, which provided a benefit to our net interest yield of approximately 17 basis points on an annualized basis. The decrease in the average cost of our debt was partially offset by a decrease in the average yield on our interest-earning assets of 27 basis points to

5.25%, which was due in part to the accelerated amortization of net deferred premium amounts reflecting faster than expected prepayment speeds in response to the decline in interest rates during the quarter.

The periodic net contractual interest accruals on our interest rate swaps are not reflected in our taxable-equivalent net interest income, although we consider these amounts to be part of the cost of funding our mortgage investments. Instead, the net contractual interest accruals on our interest rate swaps are reflected in our condensed consolidated statements of operations as a component of Fair value losses, net. As indicated in Table 9 below, we recorded net contractual interest expense of $26 million for the three months ended March 31, 2008. In comparison, we recorded net contractual interest income on our interest rate swaps totaling $34 million for the three months ended March 31, 2007. The economic effect of the interest accruals on our interest rate swaps, which is not reflected in the comparative net interest yields presented above, resulted in an increase in our funding costs of approximately 1 basis point for the three months ended March 31, 2008 and a reduction in our funding costs of approximately 1 basis point for the three months ended March 31, 2007.

If current market conditions continue, we expect our taxable-equivalent net interest yield (excluding the benefit we received from the redemption of step-rate debt securities during the first quarter of 2008) to continue to increase for the remainder of 2008.

Guaranty Fee Income

Table 6 shows the components of our guaranty fee income, our average effective guaranty fee rate, and Fannie Mae MBS activity for the three months ended March 31, 2008 and 2007. As discussed above, the change in measuring the fair value of our guaranty obligations affects not only the losses recognized at inception of our guaranty contract, but also our guaranty fee income. Although we will no longer recognize losses at the inception of our guaranty contracts, we will continue to accrete previously recognized losses into our guaranty fee income over the remaining life of the mortgage loans underlying the MBS.

Table 6: Guaranty Fee Income and Average Effective Guaranty Fee Rate(1)

	For the Three Months Ended March 31,				
	2008		2007		Amount
	Amount	Rate(2)	Amount	Rate(2)	Variance
	(Dollars in millions)				
Guaranty fee income/average effective guaranty fee rate, excluding certain fair value adjustments and buy-up impairment	$ 1,719	29.0bp	$ 1,100	21.8bp	56%
Net change in fair value of buy-ups and guaranty assets	62	1.0	2		3,000
Buy-up impairment	(29)	(0.5)	(4)		625
Guaranty fee income/average effective guaranty fee rate(3)	$ 1,752	29.5bp	$ 1,098	21.8bp	60%
Average outstanding Fannie Mae MBS and other guarantees(4)	$ 2,374,033		$ 2,017,471		18%
Fannie Mae MBS issues(5)	168,592		132,423		27

(1) Guaranty fee income primarily consists of contractual guaranty fees related to Fannie Mae MBS held in our portfolio and held by third-party investors, adjusted for (1) the amortization of upfront fees and impairment of guaranty assets, net of a proportionate reduction in the related guaranty obligation and deferred profit, and (2) impairment of buy-ups. The average effective guaranty fee rate reflects our average contractual guaranty fee rate adjusted for the impact of amortization of deferred amounts and buy-up impairment. Losses recognized at inception on certain guaranty contracts are excluded from guaranty fee income and the average effective guaranty fee rate; however, as described in footnote 3 below, the accretion of these losses into income over time is included in our guaranty fee income and average effective guaranty fee rate.

(2) Presented in basis points and calculated based on annualized amounts of our guaranty fee income components divided by average outstanding Fannie Mae MBS and other guarantees for each respective period.

(3) Losses recognized at inception on certain guaranty contracts, which are excluded from guaranty fee income, are recorded as a component of our guaranty obligation. We accrete a portion of our guaranty obligation, which includes these losses, into income each period in proportion to the reduction in the guaranty asset for payments received. This accretion increases our guaranty fee income and reduces the related guaranty obligation.

(4) Other guarantees includes $40.8 billion and $41.6 billion as of March 31, 2008 and December 31, 2007, respectively, and $20.6 billion and $19.7 billion as of March 31, 2007 and December 31, 2006, respectively, related to long-term standby commitments we have issued and credit enhancements we have provided.

(5) Reflects unpaid principal balance of Fannie Mae MBS issued and guaranteed by us, including mortgage loans held in our portfolio that we securitized during the period and Fannie Mae MBS issued during the period that we acquired for our portfolio.

The 60% increase in guaranty fee income from the first quarter of 2007 was driven by an 18% increase in average outstanding Fannie Mae MBS and other guarantees, and a 35% increase in the average effective guaranty fee rate to 29.5 basis points from 21.8 basis points. The increase in average outstanding Fannie Mae MBS and other guarantees reflected the significant growth in our market share of mortgage-related securities issuances since the first quarter of 2007, due in large part to the disruption in the credit and mortgage markets and dramatic shift in market dynamics, including a significant reduction in the issuances of private-label mortgage-related securities.

The increase in our average effective guaranty fee rate was due in part to accretion of our guaranty obligation and deferred profit amounts into income, reflecting the impact of accelerated amortization due to faster expected prepayment speeds stemming from the decrease in interest rates during the quarter. The accretion of the guaranty obligation related to losses previously recognized at inception on certain guaranty contracts totaled an estimated $297 million and $92 million for the three months ended March 31, 2008 and 2007, respectively.

We implemented targeted guaranty fee pricing increases and an adverse market delivery charge of 25 basis points for all loans delivered to us effective March 1, 2008. As a result of these price increases, our average guaranty charge fee on acquisitions increased to 27.9 basis points for the month of March 2008, from 26.5 basis points for December 2007 and 25.6 basis points for March 2007. The impact of our targeted pricing increases during the first quarter of 2008 was partially offset by a reduction in the acquisition of higher-risk loan products, for which we typically charge a higher guaranty fee.

We announced a comprehensive update to our risk assessment, eligibility criteria and pricing that is effective June 1, 2008. The changes in our risk assessment and eligibility criteria are likely to result in changes in the risk profile of our new business, which may contribute to a reduction in our guaranty business volume for the year relative to our business volume for 2007. However, we expect overall growth in our guaranty book of business for the year and an increase in our guaranty fee income for 2008 relative to 2007.

Trust Management Income

Trust management income decreased to $107 million for the first quarter of 2008, from $164 million for the first quarter of 2007. The decrease was attributable to the reduction in short-term interest rates during the first quarter of 2008, which reduced the amount of float income derived from the cash flows between the date of remittance of mortgage and other payments to us by servicers and the date of distribution of these payments to MBS certificateholders.

Fee and Other Income

Fee and other income decreased to $227 million for the first quarter of 2008, from $277 million for the first quarter of 2007. The decrease was due to a reduction in multifamily fees that reflected lower liquidations during the first quarter of 2008.

Losses on Certain Guaranty Contracts

Beginning on January 1, 2008 with our adoption of SFAS 157, we changed how we measure the fair value of our guaranty obligation related to new MBS issuances. As a result of this change, we did not record any losses on certain guaranty contracts for the first quarter of 2008. We will no longer recognize losses or record deferred profit in our consolidated financial statements at inception of our guaranty contracts for MBS issued subsequent to

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December 31, 2007 because the estimated fair value of the guaranty obligation at inception will now equal the estimated fair value of the total compensation received. For further discussion of this change, see Critical Accounting Policies and Estimates Fair Value of Financial Instruments Change in Measuring the Fair Value of Guaranty Obligations and Notes to Condensed Consolidated Financial Statements Note 1, Summary of Significant Accounting Policies.

We recorded losses on certain guaranty contracts totaling $283 million for the first quarter of 2007. These losses reflected the increase in the estimated market risk premium that a market participant would require to assume our guaranty obligations due to the decline in home prices and deterioration in credit conditions. As of March 31, 2008, unamortized losses on certain guaranty contracts in our condensed consolidated balance sheet were $2.2 billion. The unamortized losses represent the net guaranty asset and guaranty obligation in our condensed consolidated balance sheet that will be accreted into income over the remaining life of the mortgage loans underlying our Fannie Mae MBS as a component of guaranty fee income. The accretion to be recognized in future periods will be more than the original losses on certain guaranty contracts as a result of upfront cash fees and credit enhancements received at the inception of the guaranty arrangement that reduced the original recorded loss.

Investment Gains (Losses), Net

We summarize the components of investment gains (losses), for the three months ended March 31, 2008 and 2007 below in Table 7 and discuss significant changes in these components between periods.

Table 7: Investment Gains (Losses), Net

	For the Three Months Ended March 31,	
	2008	2007
	(Dollars in millions)	
Other-than-temporary impairment on AFS securities[1]	$ (55)	$ (3)
Lower-of-cost-or-market (LOCOM) adjustments on held-for-sale loans	(71)	(3)
Gains on Fannie Mae portfolio securitizations, net	42	49
Gains on sale of AFS securities, net	33	271
Other investment losses, net	(60)	(19)
Investment gains (losses), net	$ (111)	$ 295

(1) Excludes other-than-temporary impairment on guaranty assets and buy-ups as these amounts are recognized as a component of guaranty fee income. Refer to Table 6: Guaranty Fee Income and Average Effective Guaranty Fee Rate.

The $406 million unfavorable variance in investment gains (losses), net, for the first quarter of 2008 compared with the first quarter of 2007 was primarily attributable to the following:

An increase of $52 million in other-than-temporary impairment on AFS securities. We recognized other-than-temporary impairment on our AFS securities totaling $55 million for the first quarter of 2008, attributable to declines in the creditworthiness of certain securities, principally related to subprime private-label securities. In contrast, we recognized other-than-temporary impairment of $3 million for the first quarter of 2007.

A $68 million increase in losses resulting from lower-of-cost-or-market adjustments on HFS loans, due to the significant widening of credit spreads during the quarter.

A decrease of $238 million in gains on the sale of AFS securities, net. We recorded net gains of $33 million and $271 million for the first quarters of 2008 and 2007, respectively, related to the sale of securities totaling $13.5 billion and $17.0 billion, respectively. The investment gains recorded during the first quarter of 2007 were attributable to the recovery in value of securities we sold that we had previously written down due to other-than-temporary impairment.

Fair Value Losses, Net

Fair value losses, net consists of derivatives fair value gains and losses, gains and losses on trading securities, debt foreign exchange gains and losses, and debt fair value gains and losses. Generally, we expect changes in the fair value of our trading securities to move inversely to changes in the fair value of our derivatives, resulting in an offset against a portion of our derivatives gains and losses. Because the fair value of our derivatives and trading securities are affected not only by interest rates, but also by other factors such as volatility and, for trading securities, changes in credit spreads, changes in the fair value of our trading securities may not always move inversely to changes in the fair value of our derivatives. Consequently, the gains and losses on our trading securities may not result in partially offsetting losses and gains on our derivatives. In addition, our foreign currency exchange gains and losses on our foreign-denominated debt are offset in part by corresponding losses and gains on foreign currency swaps. We seek to eliminate our exposure to fluctuations in foreign exchange rates by entering into foreign currency swaps that effectively convert debt denominated in a foreign currency to debt denominated in U.S. dollars. By presenting these items together in our condensed consolidated results of operations, we are able to show the net impact of mark-to-market adjustments that generally result in offsetting gains and losses due to changes in interest rates. Table 8 summarizes the components of fair value losses, net for the three months ended March 31, 2008 and 2007.

Table 8: Fair Value Losses, Net

	For the Three Months Ended March 31,	
	2008	**2007**
	(Dollars in millions)	
Derivatives fair value losses, net	$ (3,003)	$ (563)
Gains (losses) on trading securities, net	(1,227)	61
Derivatives and trading securities fair value losses, net	(4,230)	(502)
Debt foreign exchange losses, net	(157)	(64)
Debt fair value gains, net	10	
Fair value losses, net	$ (4,377)	$ (566)

We recorded fair value losses, net of $4.4 billion for the first quarter of 2008, compared with fair value losses of $566 million for the first quarter of 2007. As a result of the decrease in swap interest rates during the first quarter of 2008, we experienced a significant increase in fair value losses on our derivatives. We also experienced fair value losses on our trading securities due to the significant widening of credit spreads during the quarter, which more than offset an increase in value attributable to the decline in interest rates during the period.

Beginning in mid-April 2008, we implemented fair value hedge accounting with respect to a portion of our derivatives to hedge, for accounting purposes, the interest rate risk related to some of our mortgage assets. Hedge accounting allows us to offset the fair value gains or losses on some of our derivative instruments against the corresponding fair value losses or gains attributable to changes in interest rates on the specific hedged mortgage assets. As a result, we expect a reduction in the level of volatility in our financial results that is attributable to changes in interest rates.

However, our implementation of hedge accounting will not affect our exposure to spread risk or the volatility in our financial results that is attributable to changes in credit spreads. Because changes in the fair value of our trading securities and derivatives are affected by market fluctuations that cannot be predicted, we cannot estimate the impact of changes in these items for the full year. We disclose the sensitivity of changes in the fair value of our trading securities and derivatives to changes in interest rates in Risk Management Interest Rate Risk Management and Other Market Risks Measuring Interest Rate Risk. Below we provide additional information on the most significant components of our fair value losses, net.

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Derivatives Fair Value Losses, Net

Table 9 presents, by type of derivative instrument, the fair value gains and losses on our derivatives for the three months ended March 31, 2008 and 2007. Table 9 also includes an analysis of the components of derivatives fair value gains and losses attributable to net contractual interest accruals on our interest rate swaps, the net change in the fair value of terminated derivative contracts through the date of termination and the net change in the fair value of outstanding derivative contracts. We consider the net contractual interest accruals on our interest rate swaps to be part of the cost of funding our mortgage investments.

Table 9: Derivatives Fair Value Losses, Net

	For the Three Months Ended March 31,	
	2008	**2007**
	(Dollars in millions)	
Risk management derivatives:		
Swaps:		
Pay-fixed	$ (15,895)	$ (486)
Receive-fixed	12,792	363
Basis	5	(14)
Foreign currency[1]	146	20
Swaptions:		
Pay-fixed	(189)	(123)
Receive-fixed	273	(303)
Interest rate caps	(1)	1
Other[2]	64	(1)
Risk management derivatives fair value losses, net	(2,805)	(543)
Mortgage commitment derivatives fair value losses, net	(198)	(20)
Total derivatives fair value losses, net	$ (3,003)	$ (563)
Risk management derivatives fair value gains (losses) attributable to:		
Net contractual interest income (expense) accruals on interest rate swaps	$ (26)	$ 34
Net change in fair value of terminated derivative contracts from end of prior year to date of termination	204	(82)
Net change in fair value of outstanding derivative contracts, including derivative contracts entered into during the period	(2,983)	(495)
Risk management derivatives fair value losses, net[3]	$ (2,805)	$ (543)

	2008	**2007**

5-year swap interest rate:		
As of January 1	4.19%	5.10%
As of March 31	3.31	4.99

(1) Includes the effect of net contractual interest expense accruals of approximately $3 million and $18 million for the three months ended March 31, 2008 and 2007, respectively. The change in fair value of foreign currency swaps excluding this item resulted in a net gain of $149 million and $38 million for the three months ended March 31, 2008 and 2007, respectively.

(2) Includes MBS options, forward starting debt, swap credit enhancements and mortgage insurance contracts.

(3) Reflects net derivatives fair value losses, excluding mortgage commitments, recognized in the condensed consolidated statements of operations.

The derivatives fair value losses of $3.0 billion for the first quarter of 2008 were primarily driven by the decline in interest rates during the quarter. The 5-year swap interest rate, which is presented in Table 9, fell by

88 basis points to 3.31% as of March 31, 2008 from 4.19% as of December 31, 2007. This decline resulted in fair value losses on our pay-fixed swaps that exceeded the fair value gains on our receive-fixed swaps. We experienced partially offsetting fair value gains on our option-based derivatives due to an increase in implied volatility that more than offset the combined effect of the time decay of these options and the decrease in swap interest rates during the first quarter of 2008.

The derivatives fair value losses of $563 million for the first quarter of 2007 also were primarily a result of a decline in interest rates during the quarter, as the 5-year swap interest rate fell by 11 basis points to 4.99% as of March 31, 2007 from 5.10% as of December 31, 2006. This decline contributed to a reduction in the fair value of our pay-fixed interest rate swaps, resulting in a reduction in the aggregate net fair value of our interest rate swaps. We also experienced a decrease in the aggregate fair value of our option-based derivatives due to the combined effect of the time decay of these options and a decrease in implied volatility during the quarter.

See Consolidated Balance Sheet Analysis Derivative Instruments for additional information on the effect of our derivatives on our consolidated financial statements and Risk Management Interest Rate Risk Management and Other Market Risks Derivatives Activity for information on changes in our derivatives activity and the outstanding notional amounts of our derivatives.

Gains (Losses) on Trading Securities, Net

We recorded losses on trading securities of $1.2 billion during the first quarter of 2008. These losses were primarily related to a decline in value of our Alt-A, subprime and commercial real estate private-label mortgage-related securities due to the significant widening of credit spreads during the period, which more than offset an increase in value attributable to the decline in interest rates during the period. In contrast, we recorded gains on trading securities of $61 million during the first quarter of 2007, due to a decrease in interest rates and implied volatility during the quarter.

In the fourth quarter of 2007, we began designating an increasingly large portion of the agency mortgage-related securities that we purchased as trading securities to allow a better offset of the changes in the fair value of these securities and the derivative instruments. In addition, in conjunction with our January 1, 2008 adoption of SFAS 159, we elected to reclassify all of our non-mortgage investment securities to trading from AFS. Our portfolio of trading securities increased to $110.6 billion as of March 31, 2008, from $64.0 billion as of December 31, 2007. The decline in interest rates during the first quarter of 2008 contributed to an increase in the fair value of our trading securities. This increase, however, was more than offset by a decrease in the fair value of these securities due to the significant widening of credit spreads, particularly related to private-label mortgage-related securities backed by Alt-A and subprime loans and commercial mortgage-backed securities (CMBS) backed by multifamily mortgage loans.

We provide additional information on our trading and AFS securities in Consolidated Balance Sheet Analysis Trading and Available-for-Sale Investment Securities and disclose the sensitivity of changes in the fair value of our securities to changes in interest rates in Risk Management Interest Rate Risk Management and Other Market Risks Measuring Interest Rate Risk.

Debt Foreign Exchange Losses, Net

We recorded a foreign currency exchange loss of $157 million on our foreign-denominated debt for the first quarter of 2008, primarily due to the continued weakening of the U.S. dollar. In comparison, we recorded a foreign currency exchange loss of $64 million for the first quarter of 2007. These amounts are offset in part by gains on our foreign currency swaps, which are included in derivatives fair value losses, net and presented in Table 9 above.

Losses from Partnership Investments

Losses from partnership investments decreased to $141 million for the first quarter of 2008, from $165 million for the first quarter of 2007, primarily due to a reduction in net operating losses attributable to a decrease in our LIHTC and other tax-advantaged partnership investments. These reduced losses were partially offset by an increase in net operating losses related to our continued investment in other non-LIHTC affordable rental housing partnerships. For additional information on tax credits associated with our LIHTC investments, refer to Federal Income Taxes below.

Administrative Expenses

Administrative expenses decreased to $512 million for the first quarter of 2008, from $698 million for the first quarter of 2007, reflecting significant reductions in restatement and related regulatory expenses and a reduction in our ongoing operating costs due to efforts we undertook in 2007 to increase productivity and lower our administrative costs. We are actively managing our administrative expenses with the intent to maintain our ongoing operating costs for 2008, which exclude costs associated with our restatement, such as regulatory examinations and litigation related to the restatement, near the $2.0 billion level we achieved in 2007.

Credit-Related Expenses

The credit-related expenses included in our condensed consolidated statements of operations consist of the provision for credit losses and foreclosed property expense. Our credit-related expenses increased to $3.2 billion for the first quarter of 2008, from $321 million for the first quarter of 2007. Table 10 details the components of our credit-related expenses. We discuss each of these components below.

Table 10: Credit-Related Expenses

	For the Three Months Ended March 31, 2008	2007
	(Dollars in millions)	
Provision attributable to guaranty book of business	$ 2,345	$ 180
Provision attributable to SOP 03-3 fair value losses	728	69
Total provision for credit losses[(1)]	3,073	249
Foreclosed property expense	170	72
Credit-related expenses	$ 3,243	$ 321

(1) Reflects total provision for credit losses reported in Table 11 below under Combined loss reserves.

The $2.9 billion increase in our credit-related expenses for the first quarter of 2008 was principally due to the substantial increase of $2.2 billion in our provision for credit losses attributable to our guaranty book of business, reflecting the impact of the severe deterioration in the housing market, which has resulted in a significant increase in default rates and average loss severities, particularly related to loans in certain states, certain higher risk loan categories and loans originated in 2005 to 2007. We also experienced an increase of $659 million in our provision for credit losses attributable to SOP 03-3 fair value losses. Foreclosed property expense rose by $98 million due to an increase in our inventory of foreclosed properties, reflecting a sharp rise in the rate of foreclosures and a significant increase in the amount of time required to dispose of foreclosed properties, as well as reduced prices from the sale of foreclosed properties.

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Provision Attributable to Guaranty Book of Business

Our allowance for loan losses and reserve for guaranty losses, which we collectively refer to as our combined loss reserves, provide for probable credit losses inherent in our guaranty book of business as of each balance sheet date. We build our loss reserves, through the provision for credit losses, for losses that we believe have been incurred and will eventually be recorded over time as charge-offs. When we determine that a loan is uncollectible, we record the charge-off against our loss reserves. We record recoveries of previously charged-off amounts as a credit to our loss reserves. Table 11, which summarizes changes in our combined loss reserves for the three months ended March 31, 2008 and 2007, details the provision for credit losses recognized in our condensed consolidated statements of operations each period and the charge-offs recorded against our loss reserves.

Table 11: Allowance for Loan Losses and Reserve for Guaranty Losses

	For the Three Months Ended March 31, 2008	2007
	(Dollars in millions)	
Changes in loss reserves:		
Allowance for loan losses:		
Beginning balance	$ 698	$ 340
Provision	544	17
Charge-offs(1)	(279)	(62)
Recoveries	30	17
Ending balance(2)	$ 993	$ 312
Reserve for guaranty losses:		
Beginning balance	$ 2,693	$ 519
Provision	2,529	232
Charge-offs(3)	(1,037)	(153)
Recoveries	17	20
Ending balance	$ 4,202	$ 618
Combined loss reserves:		
Beginning balance	$ 3,391	$ 859
Provision	3,073	249
Charge-offs(1)(3)	(1,316)	(215)
Recoveries	47	37
Ending balance(2)	$ 5,195	$ 930
Allocation of loss reserves:		
Balance at end of each period attributable to:		
Single-family	$ 5,140	$ 862

Multifamily	55	68
Total	$ 5,195	$ 930
Loss reserve ratios:		
Percent of combined allowance and reserve for guaranty losses in each category to related guaranty book of business:(4)		
Single-family	0.19%	0.04%
Multifamily	0.04	0.06
Total	0.18	0.04

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(1) Includes accrued interest of $78 million and $25 million for the three months ended March 31, 2008 and 2007, respectively.

(2) Includes $50 million and $42 million as of March 31, 2008 and 2007, respectively, for acquired loans subject to the application of SOP 03-3.

(3) Includes charges recorded at the date of acquisition of $728 million and $69 million for the three months ended March 31, 2008 and 2007, respectively, for acquired loans subject to the application of SOP 03-3 where the acquisition cost exceeded the fair value of the acquired loan.

(4) Represents ratio of combined allowance and reserve balance by loan type to the guaranty book of business by loan type.

The continued weakness in the housing market, including the national decline in home prices, the decrease in home sales and the substantial increase in the number of months supply of housing inventory, has contributed to significantly higher default rates and loan loss severities, which are the primary factors in determining the level of our loss reserves. The number of properties we acquired through foreclosure in the first quarter of 2008 increased by 88% from the first quarter of 2007 to 20,108 properties, and our average loan loss severity more than doubled. In response to these conditions as well as our view of current economic and market trends, we substantially increased our loss reserves in the first quarter of 2008 by recording a provision for credit losses attributable to our guaranty book of business of $2.3 billion, compared with $180 million for the first quarter of 2007. The $2.3 billion was comprised of $541 million related to actual charge-offs that occurred during the first quarter of 2008 and an incremental provision of $1.8 billion to further build our loss reserves. As a result of the increase in our provision for credit losses, our loss reserves totaled $5.2 billion, or 0.18% of our guaranty book of business, as of March 31, 2008, compared with $3.4 billion, or 0.12% of our guaranty book of business, as of December 31, 2007. If the current negative trend in the housing market continues, we expect a further increase in our loss reserves during 2008 due to higher delinquencies, defaults and loan loss severities.

Provision Attributable to SOP 03-3 Fair Value Losses

We experienced a substantial increase in the SOP 03-3 fair value losses recorded upon the purchase of seriously delinquent loans from MBS trusts for the first quarter of 2008 relative to the first quarter of 2007, due to the significant disruption in the mortgage market and severe reduction in market liquidity for certain mortgage products, such as delinquent loans, that has persisted since the beginning of July 2007. As indicated in Table 10 above, SOP 03-3 fair value losses increased to $728 million for the first quarter of 2008, compared with $69 million for the first quarter of 2007. We describe how we account for SOP 03-3 fair value losses and the process we use to value loans subject to SOP 03-3 in Part II Item 7 MD&A Critical Accounting Policies and Estimates Fair Value of Loans Purchased with Evidence of Credit Deterioration Effect on Credit-Related Expenses of our 2007 Form 10-K.

Table 12 provides a quarterly comparison of the average market price, as a percentage of the unpaid principal balance and accrued interest, of seriously delinquent loans purchased from MBS trusts and additional information related to these loans. The decrease in the average price to 62% during the first quarter of 2008 reflected the impact of a substantial decline in prices during the month of March 2008, to 59% from 66% for the month of January 2008.

Table 12: Statistics on Seriously Delinquent Loans Purchased from MBS Trusts Subject to SOP 03-3

2008	2007	2006

	Q1	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
Average market price[1]	62%	70%	72%	93%	94%	95%	95%	95%	96%
Unpaid principal balance and accrued interest of loans purchased (dollars in millions)	$ 1,704	$ 1,832	$ 2,349	$ 881	$ 1,057	$ 899	$ 714	$ 759	$ 2,022
Number of seriously delinquent loans purchased	10,586	11,997	15,924	6,396	8,009	7,637	6,344	6,953	17,039

(1) The value of primary mortgage insurance is included as a component of the average market price.

Table 13 presents activity related to seriously delinquent loans subject to SOP 03-3 purchased from MBS trusts under our guaranty arrangements for the three months ended March 31, 2008.

Table 13: Activity of Seriously Delinquent Loans Purchased from MBS Trusts Subject to SOP 03-3

	Contractual Amount[1]	Market Discount	Allowance for Loan Losses	Net Investment
		(Dollars in millions)		
Balance as of December 31, 2007	$ 8,096	$ (991)	$ (39)	$ 7,066
Purchases of delinquent loans	1,704	(728)		976
Provision for credit losses			(35)	(35)
Principal repayments	(180)	46	1	(133)
Modifications and troubled debt restructurings	(915)	331	5	(579)
Foreclosures, transferred to REO	(619)	169	18	(432)
Balance as of March 31, 2008	$ 8,086	$ (1,173)	$ (50)	$ 6,863

(1) Reflects contractually required principal and accrued interest payments that we believe are probable of collection.

Tables 14 and 15 provide information about the re-performance, or cure rates, of seriously delinquent single-family loans we purchased from MBS trusts during the first quarter of 2008, each of the quarters for 2007 and each of the years 2004 to 2006, as of both (1) March 31, 2008 and (2) the end of each respective period in which the loans were purchased. Table 14 includes all seriously delinquent loans we purchased from our MBS trusts, while Table 15 includes only those seriously delinquent loans that we purchased from our MBS trusts because we intended to modify the loan.

We believe there are inherent limitations in the re-performance statistics presented in Tables 14 and 15, both because of the significant lag between the time a loan is purchased from an MBS trust and the conclusion of the delinquent loan resolution process and because, in our experience, it generally takes at least 18 to 24 months to assess the ultimate re-performance of a delinquent loan. Accordingly, these re-performance statistics, particularly those for more recent loan purchases, are likely to change, perhaps materially. As a result, we believe the re-performance rates as of March 31, 2008 for delinquent loans purchased from MBS trusts during 2008 and 2007, and, to a lesser extent, the latter half of 2006, may not be indicative of the ultimate long-term performance of these loans. Moreover, as discussed in more detail following these tables, our cure rates may be affected by changes in our loss mitigation efforts and delinquent loan purchase practices.

Table 14: Re-performance Rates of Seriously Delinquent Single-Family Loans Purchased from MBS Trusts[1]

	Status as of March 31, 2008								
	2008	2007							
	Q1	Q4	Q3	Q2	Q1	2007	2006	2005	2004

Cured without modification(2)	7%	14%	18%	18%	25%	18%	37%	44%	43%
Cured with modification(3)	37	35	19	34	29	28	28	16	15
Total cured	44	49	37	52	54	46	65	60	58
Defaults(4)	2	11	25	18	23	19	22	32	37
90 days or more delinquent	54	40	38	30	23	35	13	8	5
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%

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	Status as of the End of Each Respective Period								
	2008	**2007**							
	Q1	**Q4**	**Q3**	**Q2**	**Q1**	**2007**	**2006**	**2005**	**2004**
Cured without modification[2]	7%	11%	10%	11%	17%	16%	32%	31%	33%
Cured with modification[3]	37	26	12	31	26	26	29	12	12
Total cured	44	37	22	42	43	42	61	43	45
Defaults[4]	2	4	6	3	3	13	9	12	14
90 days or more delinquent	54	59	72	55	54	45	30	45	41
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%

(1) Re-performance rates calculated based on number of loans.

(2) Loans classified as cured without modification consist of the following: (1) loans that are brought current without modification; (2) loans that are paid in full; (3) loans that are repurchased by lenders; (4) loans that have not been modified but are returned to accrual status because they are less than 90 days delinquent; (5) loans for which the default is resolved through long-term forbearance; and (6) loans for which the default is resolved through a repayment plan. We do not extend the maturity date, change the interest rate or otherwise modify the principal amount of any loan that we resolve through long-term forbearance or a repayment plan unless we first purchase the loan from the MBS trust.

(3) Loans classified as cured with modification consist of loans that are brought current or are less than 90 days delinquent as a result of resolution of the default under the loan through the following: (1) a modification that does not result in a concession to the borrower; or (2) a modification